TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 238

THE UNITED STATES OF AMERICA, PETITIONER

vs.

STATE OF NEW YORK

No. 251

STATE OF NEW YORK, PETITIONER

vs.

THE UNITED STATES OF AMERICA

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI IN NO. 238 FILED JULY 5, 1941
PETITION FOR CERTIORARI IN NO. 251 FILED JULY 9, 1941
CERTIORARI GRANTED OCTOBER 13, 1941

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1 In the United States Circuit Court of Appeals for the Second Circuit

In Bankruptcy No. 27444

In the Matter of INDEPENDENT AUTOMOBILE FORWARDING CORPORATION, BANKRUPT

STATE OF NEW YORK, APPELLANT

vs.

UNITED STATES OF AMERICA, APPELLEE

Statement Under Rule XIII

By order of the District Court for the Western District of New York, entered on the 26th day of April 1938, the above-named corporation was adjudged a bankrupt and Claire M. Britt was appointed trustee in liquidation. Priority claims were filed by the appellee as follows:

Taxes under Titles VIII and IX of the Social Security Act	$7,036.98
1937 Capital Stock tax	307.13

Priority claims were filed by the appellant as follows:

Taxes under Sections 183 and 184 of the Tax Law	$2,720.80
Taxes under Article 18 of the Labor Law	3,305.82

By stipulation, dated June 9, 1939, between the Attorney for the United States and Attorney for the State of New York the objections raised by the State of New York to claims of the United States were submitted to Honorable John Knight, United States District Judge for the Western District of New York, in the first instance. Order, dated June 19, 1939, allowed claims of the

2 United States in full. Order allowing appeal by the State of New York to this Court was signed by Honorable John Knight on July 24, 1939. Thereafter and by reason of the amendments to the Social Security Act, enacted August 10, 1939, stipulation was entered into by and between the Attorney for the State of New York and the Attorney for the United States in pursuance of which an order was made by the Honorable Learned Hand, Chief Judge of this Court, discontinuing said appeal and remanding the case to the District Court for the Western District of New York for resettlement of the order of June 23, 1939, in accordance with the amendments to the Social Security Act, enacted August 10, 1939.

This appeal is from the resettled order of the United States District Court for the Western District of New York, Honorable John Knight, United States District Judge, presiding, dated and entered in the office of the Clerk on July 15, 1940. Notice of Ap-

peal, dated July 21, 1940, was filed with the Clerk of the United States District Court for the Western District of New York on July 31, 1940.

No question was referred to any Commissioner, Master, or Referee.

The Attorney for the appellant, State of New York, is John J. Bennett, Jr.; the attorneys for the trustees, Claire M. Britt and Fred L. Hewitt, Jr., are Harter & Schork, Prudential Building, Buffalo, New York; Attorney for the appellee, United States of America, George L. Grobe, United States Attorney in and for the Western District of New York.

The names of the parties in this proceeding are set forth above. There has been no change of parties or attorneys since the commencement of this action.

3 In United States District Court, Western District of New York

[Title omitted.]

Notice of Appeal

July 21, 1940

Sirs:

Please take notice that the State of New York, claimant in the above proceeding, hereby appeals to the Circuit Court of Appeals for the Second Circuit from the Order of the United States District Court for the Western District of New York, dated July 15, 1940, and entered in the office of the Clerk of the said Court, in the above entitled cause on July 15, 1940, and from each and every part of said Order.

Dated, Albany, N. Y., July 21, 1940.

Yours, etc.,

JOHN J. BENNETT, JR.,
Attorney General,
Attorney for the State of New York,
Office and P. O. Address, Capitol, Albany, N. Y.
W. GERARD RYAN,
Assistant Attorney General.

4 To:

Hon. GEORGE L. GROBE,
United States Attorney,
502 U. S. Court House, Buffalo, New York.

HARTER AND SCHORK, Esqs.,
Attorneys for Trustee,
Prudential Building, Buffalo, New York.

CLERK, *United States District Court,*
For the Western District of New York,
United States Court House, Buffalo, New York.

In United States District Court

Order Appealed From

July 15, 1940

It appearing that the State of New York, claimant in the above proceeding, duly appealed from an order of this Court entered in the above proceeding on June 23, 1939, and it further appearing that thereafter and in accordance with a stipulation entered into by and between the attorneys for the State of New York, claimant-appellant, and the United States of America as appellee, an order was made and entered on February 7, 1940, by the Hon. Learned Hand, Chief Judge of the United States Circuit Court of Appeals, for the Second Circuit, discontinuing said appeal, and remanding the case to the District Court for the Western District of New York for the resettlement of the order of said District Court hereinabove mentioned and entered on June 23, 1939, in accordance with and in view of the amendments to the Social Security Act, enacted and effective August 10, 1939, and it further appearing that in accordance with said stipulation and the said order of the United States Circuit Court of Appeals for the Second Circuit, said matter was brought on for a hearing before the Hon. John Knight, United States District Judge in and for the Western District of New York, and after hearing John J. Bennett, Jr., Attorney General, attorney for the State of New York, claimant (Vincent Tauriello, Esq., of counsel), and George L. Grobe, United States Attorney in and for the Western District of New York, attorney for the United States of America, also a claimant in said proceeding, and due deliberation having been had thereon, and the opinion of this Court having been rendered and filed under date of July 5, 1940, now, therefore, on motion of George L. Grobe, United States Attorney in and for the Western District of New York, attorney for the United States of America, claimant in the above proceeding, it is hereby

Ordered that the balance on hand in the custody of the Trustee in the above proceeding, consisting of $3,053.19, be paid out and distributed to the United States of America and the State of New York on the respective claims of said sovereignties for taxes filed in said proceeding in the amounts set out below, viz:

United States of America, claim for Title IX, Social Security taxes	$660.10
United States of America, for all other tax claims filed in said proceeding	828.14
State of New York on its claim for unemployment compensation contributions	858.42
State of New York on all other tax claims	706.53

6 Checks in payment therefor with respect to the claims of the United States of America to be made payable to George T. McGowan, Collector of Internal Revenue for the 28th Collection District of New York, who filed the claims in this proceeding for taxes on behalf of the United States, and the checks in payment of claims of the State of New York to be made payable to the State of New York.

Dated: July 15, 1940.

JOHN KNIGHT,
United States District Judge.

In United States District Court

Petition of Claire M. Britt, Trustee

To the Honorable Justice of the United States District Court for the Western District of New York:

The Petition of Claire M. Britt, as Trustee in Liquidation of the above corporation, respectfully shows to this Court:

1. That your petitioner was duly appointed Trustee to liquidate the above-named corporation by Order of this Court entered on the 26th day of April 1938; that thereafter he duly qualified and acted and still is acting as such Trustee.

2. That under date of January 16, 1939, petitioner presented to this Court a petition setting forth in detail all of the acts and proceedings taken by this Petitioner in the Liquidation of this Estate; that such petition further set forth Petitioner's account of receipts and disbursements of Petitioner as such Trustee in

7 Liquidation; that on the basis of such petition this Court did, by Order entered on the 19th day of January 1939, direct that a hearing be had on the matters presented in the petition on February 6, 1939 and further directed that notice of such hearing be given to all creditors, stockholders and other persons interested in the Estate of the debtor; that such notice was duly given and the matter came on to be heard on such 6th day of February 1939 at which time this Court directed that the matter be adjourned and heard generally.

3. That on the 15th day of March 1939, an Order was made and entered herein approving and confirming the action of the Petitioner as Trustee in the administration and liquidation of this Estate, authorizing the settlement of the claim against the Patriotic Insurance Company for the sum of $600.00 and directing payment by Petitioner of his fee as Trustee and further directing payment to J. Francis Harter, Attorney, for fees and disbursements rendered in this proceeding and directing that the balance remaining after the making of such disbursements be retained by Petitioner, subject to further order of this Court.

4. That thereafter Petitioner performed the various acts and made the various disbursements as directed in such Order and at the present time is now holding in his hands as Trustee herein the sum of $3,053.20 to be distributed as directed by this Court.

5. That such sum of $3,053.20 is being held by Petitioner for payment to the priority creditors herein as may be directed by this Court; that such priority creditors are as follows:

United States Department of Internal Revenue, for unpaid contributions under Titles 8 and 9 of the Social Security Act, $7,036.98.

8 United States Department of Internal Revenue, 1937 Capital Stock Tax, $307.13.

New York State Department of Taxation and Finance claim for Franchise Taxes under Sections 183 and 184 of the Tax Law, $2,720.80.

New York State Unemployment Insurance Fund claim for unpaid contributions due under the Unemployment Insurance Law, $3,305.82.

6. That as appears from the above the amount of priority claims filed herein greatly exceed the amount on hand available for distribution to the priority creditors; that dispute has arisen between the United States Department of Internal Revenue and the New York State Department of Taxation and Finance as to the method of distribution of such assets remaining on hand in this Estate and as to the order of priority of the claims filed herein.

7. That the sole remaining duty and action to be performed by Petitioner in the Liquidation of this Estate is the distribution and payment of such sum remaining in Petitioner's hands; that accordingly Petitioner requests direction from this Court determining the order of priority of the various priority claims filed herein and directing the payment of the sum remaining in petitioner's hands to such of the priority creditors as may in the judgment of this Court be entitled thereto.

Wherefore, your Petitioner respectfully requests that the creditors who have filed priority claims herein be directed to show cause why an Order should not be made and entered herein determining the order of priority of the various priority claims filed herein and directing the payment and distribution of the balance

9 remaining in Petitioner's hands as Trustee in Liquidation and why upon the making of such payment and distribution as ordered by this Court the Petitioner and his surety herein should not be discharged from all further responsibility and liability as such Trustee in Liquidation and surety respectively.

CLAIRE M. BRITT,
Petitioner.

[*Duly sworn to by Claire M. Britt; jurat omitted in printing.*]

10 In the United States Circuit Court of Appeals

Stipulation

Dated February 1, 1940

[Title omitted.]

Whereas, an order, dated Buffalo, New York, July 24, 1939, by Honorable John Knight, United States District Judge for the Western District of New York, having been made granting the motion of John J. Bennett, Jr., Attorney General, Attorney for the State of New York for leave to appeal to the Circuit Court of Appeals for the Second Circuit from an order made by the United States District Judge for the Western District of New York on June 23, 1939, ordering, that the claim of the United States be allowed in full, and that the United States and the State of New York share in pari passu in the fund remaining in the hands of the Trustee, and

Whereas, an amendment to the Social Security Act having been enacted on August 10, 1939, providing as follows:

"SECTION 902. (a) Against the tax imposed by section 901
11 of the Social Security Act for the calendar year 1936, 1937, or 1938, any taxpayer shall be allowed credit for the amount of contributions, with respect to employment during such year, paid by him into an unemployment fund under a State law— * * *

"(3) Without regard to the date of payment, if the assets of the taxpayers are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction."

Now, therefore, it is hereby stipulated that the appeal in the above entitled matter be discontinued without costs to either party upon condition that an order be made by the Circuit Court of Appeals for the Second Circuit remanding the case to the District Court for the Western District of New York and directing that the order dated June 23, 1939, be resettled in accordance with the amendments to the Social Security Act enacted August 10, 1939.

Dated, February 1st, 1940.

(S) JOHN J. BENNETT, Jr.,
W. G. R.
John J. Bennett, Jr.,
Attorney General,
Attorney for Appellant.

(S) GEORGE L. GROBE,
George L. Grobe,
United States Attorney,
Attorney for Appellee.

In United States Circuit Court of Appeals

Order Discontinuing Appeal and Remanding Cause

February 7, 1940

A stipulation having been made by John J. Bennett, Jr., Attorney General, Attorney for the State of New York, Appellant, and George L. Grobe, Attorney for the United States, Appellee, discontinuing the appeal in the above entitled matter without costs to either party on condition that the case be remanded to the District Court for the Western District of New York for resettlement of the order made by the United States District Judge for the Western District of New York on June 23, 1939, in accordance with the provisions of the amendment to the Social Security Act enacted August 10, 1939;

Upon consideration thereof it is,

Ordered that the appeal in the above-entitled matter hereby is discontinued without costs to either party and the case remanded to the District Court for the Western District of New York for the resettlement of the order made by the United States District Judge for the Western District of New York, on June 23, 1939, in accordance with the amendment to the Social Security Act enacted August 10, 1939.

Dated, February 7th, 1940.

(S) LEARNED HAND, *U. S. C. J.*.

13 In United States District Court

[Title omitted.]

Opinion

July 5, 1940

Appearances: George L. Grobe, United States Attorney, by Joseph J. Doran, Assistant United States Attorney; for government. John J. Bennett, Jr., Attorney General, State of New York; Vincent A. Tauriello, W. Gerard Ryan, and Francis R. Curran, of counsel; for State of New York.

KNIGHT, District Judge:

The issue here presented is the manner of distribution of the sum of $3,053.20 remaining in the bankrupt estate. Priority claims of the United States and the State of New York for taxes will absorb the entire amount. Claims in favor of the former have been allowed as follows:

Social Security Taxes under Section IX	$3,400.49
Other Federal Taxes	3,189.19

Claims of the State were allowed as follows:

Unemployment Insurance	$3,305.82
Other State Taxes	2,720.80

Under Section 902 of the Social Security Act, in cases where the assets are insufficient to pay the state unemployment and federal social security taxes in full, it will be seen that the amount payable to the state can not be determined until the credit allowable on the federal tax is known and the said credit can not be determined until the amount payable to the state is settled. In view of the variation of these two factors in relation to each other, the United States submits the standard algebraic formula for solving quadratic equations as a method of determining the distribution percentage. Using the symbol A for the amount of the state's claim for unemployment insurance, i. e., $3,305.82; the symbol B for the total of all other taxes, i. e., $9,310.48; the symbol T for the total assets to be distributed, i. e., $3,053.20; and the symbol X for the percentage of distribution to be determined, it is found that the equation $X[(A\&B)-AX]=T$ reduces to $AX^2-(A\&B)X+T=0$. Using the quadratic formula

$$X=\frac{-b\pm\sqrt{b^2-4ac}}{2a}$$

and substituting symbols from the equation previously stated, the equation becomes

$$X=\frac{(A\&B)\pm\sqrt{(A\&B)^2-4AT}}{2A}$$

Upon substituting the known numerical equivalents in the equation and resolving it, the distribution percentage is found to be 25.967%. $858.42 will therefore be available on the state unemployment insurance claim and that amount will be credited against the social security tax claim reducing the latter to $2,542.07. The amounts payable on all claims will then be computed as follows:

Social Security Taxes	$660.10
Other federal taxes	828.14
Unemployment Insurance Taxes	858.42
Other State Taxes	706.53
	3,053.19

The state asserts that this method of computation is unsatisfactory for the reason that it is not applicable to cases wherein the assets are more than sufficient to pay the tax claims in full. It is difficult for the court to believe that in such a case an issue would arise which would require the use

of a formula for determining the distribution, and it seems sufficient to observe that the suggested formula is designed for cases such as that in hand, wherein the assets are insufficient to pay all tax claims in full.

The state further contends that the 90% credit allowed by Section 902 is not to be taken against the amount of Federal tax levied, but against the amount paid to the Federal government. The state submits an arithmetic computation whereby an initial distribution is set up based upon the ratio of each claim to the total amount of all claims. As against the amount set up for payment of social security taxes, credit of 90% is deducted and the amount of such credit distributed as in the first instance. This process is repeated until the credit available reaches the vanishing point. Under this computation the distribution would be as follows:

Social Security	$108.67
Other Federal Taxes	1,018.99
Unemployment Insurance	1,056.09
Other State Taxes	869.45
	3,053.20

The difference between the amounts payable to the state under its own computation and that of the United States is comparatively small, but it is urged that numerous other cases will involve the same question and that a rule should now be established upon which future computation may be made.

16 Section 902 of the Social Security Act, as amended, is clear and unambiguous. It must be assumed to correctly state the intent of the legislature and is not to be construed in derogation of its clear meaning. It is provided that "against the tax imposed by Section 901 * * * the taxpayer shall be allowed credit for the amount of contributions * * * paid by him into an unemployment fund under a state law * * *." However, the "total credit allowed against the tax imposed shall not exceed 90 per centum of such tax." Under the statute it is only when the payments into a state unemployment fund exceed 90% of the federal tax that any question of limitation of credit arises. The federal computation recognizes this rule by giving full credit for the proposed distribution on unemployment insurance. The state would apply the 90% credit against the amount paid to the federal government. The error in such computation is that the state would apply the credit against payments on the tax rather than against the tax itself. While it may seem unequitable to require a larger payment than would be required if the estate were

larger, the statute brings about such a result. The intent of the legislature was to compel prompt and full payment of unemployment insurance payments. If this be inequitable the change must come through amendment of the statute, not by judicial interpretation contrary to the clear meaning of the legislation.

Some question has been raised as to whether contributions under the State Unemployment Act are "taxes." The parties seem now agreed that they are. Some confusion is created by the language of Section 522 sub. 6 of the Labor Law (State Unemployment Fund) and there are certain decisions holding that such
17 contributions are not "taxes": In re Fidelity Fuel Co. (E. D. Pa. 1940); in re Mosby Coal & Mining Co., 24 F. Supp. 1022; In re William Akers, Jr. Co., 31 F. Supp. 900; State of Missouri v. Earhart, 111 F. (2d) 992; Certain of these construed state statutes differing in language from the New York Act. This, however, will make no difference in our view of the application of these cases. The contributions come within the meaning of the word "taxes" as that word has many times been construed. "A tax is defined to be 'a contribution imposed by government on individuals for the service of the state.'" Morgan v. Louisiana, 118 U. S. 455. "The character of a tax is well known. It is a charge or burden laid upon persons or property for public purposes; a forced contribution authoritatively imposed." Trevander v. Ruysdael, 299 F. 753. In re Standard Composition Co., 23 F. Supp. 391; Matter of Otto F. Lange Co., 159 F. 586. Numerous authorities have held that these contributions are in the nature of a tax. Chamberlin, Inc. v. Andrews, 271 N. Y. 1; aff'd 299 U. S. 515; Carmichael v. Southern Coal & Coke Co., 301 U. S. 495; In re 67 Wall St. Restaurant Co., 23 F. Supp. 672; In re Oshkosh Foundry Co., 28 F. Supp. 412; In re Mytinger, 31 F. Supp. 977. The question of whether this state statute imposes a tax is a federal question. New Jersey v. Anderson, 203 U. S. 483; In re Mid America Co., 31 F. Supp. 601; and other cases last above cited. Peculiarly is this so under the Social Security Act.

In a supplemental brief, counsel for the State for the first time urged that the claim of the United States for taxes under Title VIII of the Social Security Act as representing the tax on employees is not entitled to priority under Section 64 of the Bankruptcy Act.

This relates to one-half of the tax imposed under Section
18 801 of Title VIII. This contention cannot be sustained.

The tax is imposed on the employer. Section 802 (a) reads: "Every employer * * * hereby made liable for the payment of the tax." Gulf Oil Co. v. Grady (In re Conklin), 42 A. B. R.

(N. S.) 142 (2d C.), cited by the state is not in point. That case construed the New York tax law Article 12A, Section 228 et seq., which "makes the distributor, not the purchaser, the taxpayer, * * *."

The balance of the moneys in the hands of the trustee is directed to be distributed as follows:

State's claim of $3,305.92 for unemployment compensation contributions	$858.42
Federal claim for Title IX taxes giving effect to credit	660.10
All other State taxes	706.53
All other Federal tax claims	828.14
Total	3,053.19

July 5, 1940.

JOHN KNIGHT,
United States District Judge.

19 In United States District Court

[Title omitted.]

Assignment of Errors

The State of New York, a priority creditor of the above bankrupt, in connection with its appeal herein, sets forth that in the order of the United States District Court for the Western District of New York, dated July 15, 1940, manifest errors were committed to the prejudice of said creditor, the State of New York, to wit:

First. The Court erred in ordering that the claim of the United States for taxes under Title IX of the Social Security Act for the year 1937, filed in the amount of $3,400.49, be paid in the amount of $660.10 from the remaining assets in the bankrupt estate, and failed to direct that the aforesaid claim be reduced by the amount of unpaid taxes due under the New York State Unemployment Insurance Law for the year 1937, but not to exceed 90% of
20 the tax imposed under Title IX of the Social Security Act, and failed to allow as a credit against the taxes imposed under Title IX of the Social Security Act for the year 1937 the amount payable to the State of New York for contributions due under the New York State Unemployment Insurance Law for the year 1937.

Second. The Court erred in ordering that the claims of the United States for taxes under Sections 801 and 804 of Title VIII of the Social Security Act and 1937 Capital Stock tax, filed in the

aggregate amount of $3,189.19, be paid in the amount of $828.14 from the remaining assets in the bankrupt estate, and failed to direct that the claim of the United States for taxes assessed against employees of the bankrupt under Section 801 of Title VIII of the Social Security Act for the year 1937 be disallowed as a priority tax claim against the bankrupt estate, and that said claim be allowed only as a general claim representing a debt due from the bankrupt.

Third. The Court erred in its failure to find and determine that 90% of the claim of the United States for unpaid taxes under Title IX of the Social Security Act for the year 1937, constituted a penalty under the Bankruptcy Act and, therefore, was not allowable as a claim against the bankrupt estate.

Fourth. The Court erred in ordering distribution of the assets of the bankrupt estate herein, upon the priority tax claims filed therein in accordance with an algebraic formula, to wit:

$$X = \frac{A+B-\sqrt{(A+B)^2-4AT}}{2A}$$

21 which, in effect, constituted an erroneous interpretation of Section 902 (a) (3) of the Social Security Act, enacted August 10, 1939, as permitting the bankrupt estate to take a credit against the tax imposed by Title IX of the Social Security Act of only that portion of state unemployment insurance taxes that is actually paid upon distribution into an unemployment fund under a state law, and erroneously failed to interpret the Social Security Act as amended, as providing that insolvent estates pending during the fifty-nine-day period subsequent to August 10, 1939, are entitled to take a credit against the tax imposed under Title IX of the Social Security Act of the amount of taxes imposed under state unemployment insurance laws, but not to exceed 90% of the tax imposed under Title IX.

Fifth. The Court erred in failing to find and direct the disallowance of 90% of the United States claim for taxes under Title IX of the Social Security Act for the year 1937 on the ground that if such tax were allowed it would result in the collection of an erroneous and illegal tax from a bankrupt estate contrary to the provisions of the Bankruptcy Act.

Wherefore, the State of New York, a priority creditor of the above bankrupt, prays that for the errors aforesaid the order of

the District Court for the Western District of New York, dated July 15, 1940, ordering that distribution be made as follows:

United States of America, claim for Title IX, Social Security taxes	$660.10
United States of America, for all other tax claims filed in said proceeding	828.14
State of New York on its claim for unemployment compensation contributions	858.42
State of New York on all other tax claims	706.53

be reversed.

Dated, Albany, N. Y., August —, 1940.

JOHN J. BENNETT, JR.,
Attorney General,
Attorney for the State of New York, Appellant,
Office & P. O. Address, Capitol, Albany, N. Y.

In United States District Court.

Stipulation Designating Contents of Record

August 16, 1940

Whereas, in the above-entitled proceeding the appellant, State of New York, did on the 31st day of July 1940, file with the Clerk of the District Court for the Western District of New York, Notice of Appeal, dated July 21, 1940, from the resettled order of Honorable John Knight, District Court Judge for the Western District of New York, made on July 15, 1940, and entered in the office of the Clerk of that Court upon said day.

Now, therefore, it is hereby stipulated that the record to be certified to this Court by the Clerk of the United States District Court for the Western District of New York on said appeal shall consist of the following:

1. Statement under Rule XIII of the United States Circuit Court of Appeals for the Second Circuit.

23 2. Notice of Appeal to the Circuit Court of Appeals for the Second Circuit, dated July 21, 1940.

3. Petition of trustee subscribed May 3, 1939.

4. Stipulation discontinuing appeal, dated February 1, 1940.

5. Order of Honorable Learned Hand, Chief Judge of the United States Circuit Court for the Second Circuit, dated February 7, 1940.

6. Opinion of Honorable John Knight, dated July 5, 1940.
7. Order of Honorable John Knight, dated July 15, 1940.
8. Assignment of Errors.
9. Stipulation designating record.
10. Stipulation of true transcript.
11. Clerk's Certificate.

Dated, August 16, 1940.

JOHN J. BENNETT, JR.,
Attorney General,
Attorney for the State of New York, Appellant.
GEORGE L. GROBE,
Attorney for the United States, Appellee.

In United States District Court

Stipulation of True Transcript

August 16, 1940

It is hereby stipulated and agreed that the foregoing is a
24 true transcript of the record of said District Court in the above-entitled matter as agreed upon by the parties.

Dated: August 16, 1940.

JOHN J. BENNETT, JR.,
Attorney General,
Attorney for the State of New York, Appellant.
GEORGE L. GROBE,
Attorney for the United States, Appellee.

[Clerk's certificates to foregoing transcript omitted in printing.]

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 127. October Term, 1940

Argued February 11, 1941.—Decided March 17, 1941

In the matter of INDEPENDENT AUTOMOBILE FORWARDING CORPORATION, BANKRUPT

STATE OF NEW YORK, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

Appeal from an order of the District Court for the Western District of New York granting priority to a claim of the United States against the estate of a bankrupt for taxes for the year 1937 assessed against the bankrupt under Title VIII and Title IX of the Social Security Act and also for taxes for the same year assessed against employees of the bankrupt under Title VIII of said Act. Reversed.

Before SWAN, AUGUSTUS N. HAND and CHASE, Circuit Judges.

John J. Bennett, Jr., Attorney General; Attorney for Appellant; Henry Epstein, Solicitor General; W. Gerard Ryan, Francis R. Curran, Asst. Attorneys General, of Counsel.

Samuel O. Clark, Jr., Asst. Attorney General; J. Louis Monarch, Thomas G. Carney, Sp. Assts. to the Attorney General; George L. Grobe, U. S. Attorney; Joseph J. Doran, Asst. U. S. Attorney, for Appellee.

CHASE, Circuit Judge: The Independent Automobile Forwarding Corporation, an employer of labor to whom and to whose employees the provisions of the Federal Social Security Act (c. 531, 49 Stat. 639) were applicable, was adjudicated a bankrupt in the District Court for the Western District of New York on April 26, 1938. The liquidation of its property in the bankruptcy proceedings brought into the hands of the trustee assets insufficient to pay in full the claims filed and allowed priority under Sec. 64 (a) (4) of the Bankruptcy Act. The trustee filed his petition for instructions governing the payment of such

priority claims and an order thereon was made on June 23, 1939, from which an appeal was taken to this court. Part of the claims involved were for taxes due the State of New York and part were for taxes due the United States, including some social-security taxes, and the amount of a credit allowable on the latter was changed by an amendment to the statute that became effective August 10, 1939. In accordance with a stipulation of the parties, an order was entered discontinuing that appeal without costs and remanding the case to the district court for a resettlement of its order which would give effect to the amendment. The order was resettled in a way that granted priority to all the taxes claimed by the federal government and by the state and fixed the percentage payable thereon after allowing a credit on the social security taxes to the extent payments were to be made the State of New York on its claim for taxes which were to be contributions to its unemployment fund. This appeal is from the order so made.

The only claimants who will share in the distribution are the State of New York and the United States whose claims are for taxes for the year 1937 and as their claims, regardless of any issues on this appeal, exceed the amount available for distribution there must, in any event, be a *pro rata* distribution. That is not disputed but what part of the amount due the government for social security taxes should be given priority is in dispute as well as the amount of the allowable credit. There is no controversy as to the amount due the State of New York or that its claim is entitled to priority. Nor is there any dispute but that the part of the government's claim which does not arise under the Social Security Act is also entitled to priority.

Turning now to the points in dispute, the first question is whether all taxes assessed under Title VIII and Title IX of the Social Security Act are to be granted priority under Sec. 64 (a) (4) of the Act as taxes owed by the bankrupt. Those imposed under Title IX and under Sec. 804 of Title VIII are clearly taxes assessed against the employer and so against the bankrupt. The right to priority for so much as may be the correct amount of such taxes is clear but that amount, being in controversy in respect to the Title IX taxes, will later be considered separately herein. That leaves in the first problem only the nature of the liability of the bankrupt under the Social Security Act for taxes imposed under Title VIII; Sec. 801.

Sec. 801 of Title VIII, effective in 1937, provided in so far as presently material that, "In addition to other taxes, there shall be levied, collected and paid upon the income of every individual a tax equal to the following percentage of the wages (as defined in section 811) received by him after December 31, 1936, with respect to employment (as defined in section 811) after such date; * * *." And in Sec. 802 (a) of the same Title it was provided that, "The tax imposed by section 801 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. Every employer required so to deduct the tax is hereby made liable for the payment of such tax, and is hereby indemnified against the claims and demands of any person for the amount of any such payment made by such employer."

This part of the Social Security Act laid a tax upon the employees of this bankrupt measured by a percentage of their wages and not a tax upon the bankrupt. It was taxed to a like extent under Sec. 804 of Title VIII and the two taxes put the burden of social betterment upon both the employer and the employees. As to that part of these taxes which were thus imposed upon the employees the employer was, indeed, made a compulsory tax collector and made liable for the payment of such tax. The employer, however, was liable only as an agent bound to pay whether its duty to collect was performed or not. Such liability for a debt, instead of for taxes due and owing the government, does not form the basis of a claim entitled to priority under Sec. 64 (a) (4). Gulf Oil Corp. v. Grady, 110 F. (2d) 178 (C. C. A. 2); The City of New York v. Feiring, Trustee, — F. (2d) — (C. C. A. 2) decided March —, 1941; In re General Merchandise Corporation of America, 32 F. Supp. 805. Accordingly the taxes assessed under Sec. 801 of Title VIII of the Social Security Act were erroneously allowed as a prior claim. Sec. 607 of the Revenue Act of 1934 providing that whenever any person is required to collect or withhold any tax from another person and pay it over to the United States, the tax so collected or withheld shall be held as a special trust for the United States has no application since there is no proof that any part of the government's claim is for such taxes actually collected or withheld. Even if they had been, only what could be traced could have constituted a trust fund. In re Frank, 25 F. Supp. 1005.

The remaining question involves the meaning of the credit provisions of Sec. 902 (a) of the Social Security Act as amended Aug. 10, 1939. Before the amendment it provided that: "The taxpayer may credit against the tax imposed by Sec. 901 the amount of contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year) into an unemployment fund under a state law. The total credit allowed a taxpayer under this section for all contributions paid into unemployment funds with respect to employment during such taxable year shall not exceed 90 per centum of the tax against which it is credited, and credit shall be allowed only for contributions made under laws of States certified for the taxable year as provided in section 903."

As the bankrupt made no contributions to any such state fund, there would have been no allowable credit but for the amendment of Aug. 10, 1939. That changed the time as of which credit should be allowed and in the respect here material provided that the credit should be given, "without regard to the date of payment, if the assets of the taxpayer are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction." This provision being applicable to this bankrupt taxpayer, the amount to be paid into the state unemployment fund is a factor to be given effect in determining the amount due on the government's claim. And as the amount so to be paid into the state fund is a tax for which the state has filed its claim in this proceeding the amounts due both the state and the federal governments are variables dependent upon each other since the assets are insufficient to pay both in full. The difficulty just mentioned, however, does not affect the construction of the credit statute and that will be discussed first.

The state contends that the credit should be 90% of the taxes assessable under Title IX, although less than that will actually be paid into the state unemployment fund, leaving the allowable claim only 10% of the taxes assessed. The reasoning in support of that position is that Congress never intended the government to collect as a tax for its use more than 10% of the amount assessable and provided for the credit both to induce states to create unemployment funds (Carmichael v. Southern Coal and Coke Co., 301 U. S. 495, 525-6; Steward Machine Co. v. Davis, 301 U. S. 548,

585) and to persuade employers to make contributions promptly to such funds. From which it is argued that a claim for more than 10% of the amount assessable is as to the excess a claim for a penalty not allowable in bankruptcy by virtue of Sec. 57 (j) of the Bankruptcy Act.

Congress made it clear in the amendment of 1939, Sec. 902 (i); 53 Stat. 1399 that it did not intend to impose a penalty but if one were actually imposed calling it a tax would not change its character. United States v. Constantine, 287 U. S. 287, 294; United States v. La Franca, 282 U. S. 568, 572.

We think the position of the appellant is untenable for the following reasons:

The tax is imposed by Sec. 901 of Title IX (49 Stat. 639) in unequivocal language as an excise tax upon every employer as defined in Sec. 907 measured by stated percentages for named calendar years of the total wages payable by him with respect to employment during such calendar years. The amount of the tax as a tax is thus fixed and to be translated into terms of money by computation when the facts are known. This tax is not affected by Sec. 902 providing for a credit against the tax under certain conditions. If the conditions are fulfilled the taxpayer need not pay in full but if they are not whatever may be due under the provisions of Sec. 901 is all for taxes and none the less so because the taxpayer is given an opportunity to cut down the amount due by making contributions he can use as a credit on his tax liability. That Sec. 902 is not coercive was held in Steward Machine Co. v. Davis and Carmichael v. Southern Coal and Coke Co., both supra. That being so, there is no sound basis for making any distinction between the part of the tax imposed by Sec. 901 which might be adjusted by a credit allowable under Sec. 902 and that which might not. The tax is indivisible and no part is a penalty for not fulfilling the conditions of Sec. 902. The taxpayer is but accorded a right to claim a credit available in lieu of payment *pro tanto* upon compliance with conditions named without requiring him to meet the conditions and without affecting the amount assessable as a tax.

It follows that the language of Sec. 902 controls in determining the amount of the claim under Sec. 901 which is allowable against the bankrupt estate. The credit being limited to what is contributed to the state fund, which will be less than 90% of the tax, the amount of the claim allowable is the difference between the amount assessable and the amount to be treated

as contributed to the state fund. The mutual dependence of these amounts, due to the fact that payments cannot be made in full to either claimant, requires for their determination the use of mathematics adequate to give effect to the fact that they vary with each other.

The government urged the use of an algebraic formula by which the problem was put into a quadratic equation which when solved showed that payment to the claimants of 26.97% of the allowable part of their claims would divide the entire available fund pro rata between them. The use of that will now give the correct amount payable to each claimant when the tax assessed under Sec. 801 Title VIII is disregarded in the computation because allowable only as a general claim. The state insists that no distinction should be made between the present situation and one where the assets are sufficient to pay completely. That is obviously erroneous and the more simple mathematical method of computation it advocates will not suffice here since it will give the correct result only where the amounts are not mutually dependent variables.

Because the original appeal was allowed to be withdrawn in accordance with the stipulation to resettle the order by giving effect to the amendment of Aug. 10, 1939, it has been argued that the question whether taxes due the government under Sec. 801 of Title VIII are entitled to priority is no longer open and that we are bound to treat that part of the government's claim as a prior one because it was so held below in the order from which the first appeal was taken. The short answer is that that order never was considered on its merits in this court and never became final. On the remand the court was to determine how the fund available for distribution to the only two claimants who could share should be divided between them. That necessarily involved the question of priority in all its aspects and left it an open issue.

Order reversed and cause remanded for a determination of the amounts allowable on the claims of each of the claimants in accordance with the above.

United States Circuit Court of Appeals, Second Circuit

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States

Courthouse in the City of New York, on the 12th day of April, one thousand nine hundred and forty-one.

Present: Hon. THOMAS W. SWAN, Hon. AUGUSTUS N. HAND, Hon. HARRIE B. CHASE, Circuit Judges.

In the Matter of INDEPENDENT AUTOMOBILE FORWARDING CORP., BANKRUPT, STATE OF NEW YORK, APPELLANT

Appeal from the District Court of the United States for the Western District of New York.

This cause came on to be heard on the transcript of record from the District Court of the United States for the Western District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and cause remanded for further proceedings in accordance with the opinion of this Court.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

D. E. ROBERTS, *Clerk.*

By A. M. BELL, *Deputy Clerk.*

[Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed April 12, 1941. D. E. Roberts, Clerk.]

UNITED STATES OF AMERICA,

Southern District of New York.

I, D. E. Roberts, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 34, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of In the Matter of Independent Automobile Forwarding Corp., Bankrupt, State of New York, Appellant, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this second day of June, in the year of our Lord one thousand nine hundred and forty-one, and of the Independence of the said United States the one hundred and sixty-fifth.

[SEAL] D. E. ROBERTS, *Clerk.*

U. S. GOVERNMENT PRINTING OFFICE: 1941

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Supreme Court of the United States

No. 238, October Term, 1941

THE UNITED STATES OF AMERICA, PETITIONER

vs.

STATE OF NEW YORK

Order allowing certiorari

Filed October 13, 1941

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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Supreme Court of the United States

No. 251, October Term, 1941

STATE OF NEW YORK, PETITIONER

vs.

THE UNITED STATES OF AMERICA

Order allowing certiorari

Filed October 13, 1941

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] File Nos. 45566, 45579. U. S. Circuit Court of Appeals, Second Circuit. Term No. 238. The United States of America, Petitioner vs. State of New York. Enter Henry Epstein. Term No. 251. State of New York, Petitioner vs. The United States of America. Petitions for writs of certiorari and exhibit thereto. Filed July 5, 1941, July 9, 1941. Term No. 238 O. T. 1941, 251 O. T. 1941.

U. S. GOVERNMENT PRINTING OFFICE: 1941